

C.B.D OPTION STRATEGY SERIES (CASH-FLOW/BREAKOUT/DIRECTIONAL)

Option Directional Strategies Explained – Long ITM Call/Put Strategy

By Nick Katiforis

Strategy Name: *Long ITM Call/Put Strategy*

Strategy Type: *Directional Strategy*



Strategy Objective:

The *Long ITM Call/Put Strategy* objective seeks to take advantage of a directional market move either up or down depending on market view. For an anticipated bullish move the Long ITM Call Strategy can be initiated, and for a bearish move a Long ITM Put Strategy can be initiated.

Strategy Description:

The *Long ITM Call/Put Strategy* utilises in-the-money call or put options to take a directional view of the underlying market. In-the-money options are chosen to help limit the negative effect of time-decay on bought calls by increasing the amount of option intrinsic vs option time-value.

The *Long ITM Call Strategy* at initiation is comprised of the following option leg:

- ❖ Bought in-the-money call options.

The *Long ITM Put Strategy* at initiation is comprised of the following option leg:

- ❖ Bought in-the-money put options.

Key features – Long ITM Call/Put Strategy

- ✓ Market view for Long ITM Call Strategy is bullish
- ✓ Market view for Long ITM Put Strategy is bearish
- ✓ Typically options are used with an option expiry of six months or less.
- ✓ Typically in-the-money call/put options are selected for this strategy.
- ✓ Profit potential is effectively uncapped for this strategy.
- ✓ Loss potential is limited to the net premium outlay of the purchased call/put options.
- ✓ The effects of time-decay are negative for the bought call/put.

Securities:

The Long ITM Call/Put Strategy can be implemented over selected stock options, stock indices, commodities and forex products. Please refer to the Product Disclosure Statement (PDS) and ASX information booklet available at www.halifax.com.au which explains some of the risks involved in trading options.

Strategy Order Type:

Standing Order (SO).

Volume:

Pro-rated as per risk capital selected.

Entry Instructions:

Markets are scanned; relevant factors both technical and fundamental are reviewed for entry opportunities. Once an opportunity is identified, the most appropriate strike-price and time frame is then chosen.

Orders are placed via a Standing Order (SO) on the underlying security as follows:

Long ITM Call Strategy:

- ❖ Buy call option.

Long ITM Put Strategy:

- ❖ • Buy put option.

Adjustment Instructions:

Once the *Long ITM Call/Put Strategy* positions are entered thereafter an adjustment to the strategy may be required from time to time.

Positions can be adjusted under the Standing Order (SO) as follows:

- ❖ Closing out part of the put/call option position.
- ❖ Rolling call/put options to another option strike-price.
- ❖ Writing a higher strike call option (Long ITM Call Strategy) or a lower strike put option (Long ITM Put Strategy) against the long option position.

Exit Instructions:

After weighing up various factors a determination may be made to close part or all of the *Long Call/Put Strategy*.

Positions can be exited under the Standing Order (SO) as follows:

- ❖ Closing call/put options.
- ❖ Leaving call/put options to expire worthless.

Hypothetical Trade Examples: Long ITM Call Strategy AMP Limited (AMP)

Trade Details:

❖ <i>Date of Strategy Implementation:</i>	29th October 20XX
❖ <i>Share Price:</i>	\$5.80
❖ <i>Option expiry date:</i>	23rd Mar 20XX (145 days to expiry)
❖ <i>Shares per option contract:</i>	100

<i>Buy 50 AMP Mar 5.00 calls @ \$0.85</i>	<i>Outlay:</i>	<i>\$4,250</i>
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Trading Scenarios

Neutral – AMP \$5.80

Outcome at option expiry when AMP share price remains at \$5.80:

<i>Realised gain/loss: AMP Mar 5.00 call</i>	<i>-\$0.05</i>
<i>Total realised gain/loss: (-\$0.05 x 50 contracts)</i>	<i>-\$250</i>

Upward move – AMP \$6.50

Outcome at option expiry if AMP share price moves up to \$6.50:

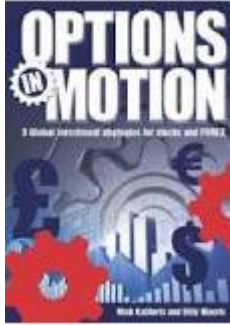
<i>Realised gain/loss: AMP Mar 5.00 call</i>	<i>\$0.65</i>
<i>Total realised gain/loss: (\$0.65 x 50 contracts)</i>	<i>\$3,250</i>

Downward move – AMP \$5.00

Outcome at option expiry if AMP share price moves down to \$5.00:

<i>Realised gain/loss: AMP Mar 5.00 call</i>	<i>-\$0.85</i>
<i>Total realised gain/loss: (-\$0.85 x 50 contracts)</i>	<i>-\$4,250</i>

Continuing the theme of directional strategies, in the next issue we turn our attention to one of the most popular option spread strategies available; the *Vertical Spread Strategy*.



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For information and material relating to Halifax's financial services and products you should read and consider our Financial Services Guide (FSG) and Product Disclosure Statement (PDS) which can be found at www.halifaxonline.com.au.